72-1544

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IN THE

Supreme Court of the United States

October Term, 1972

NO. 72-1541

H. L. H. ENTERPRISES, INC. AND HARRY L. CHAMBERS, *Petitioners*

v.

A. W. McGREGOR, KERVIN E. JACOB AND J. W. ROOKS, *Respondents*

Petition for a Writ of Certiorari to the United States Court of Appeals for the 5th Circuit

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H. L. H. ENTERPRISES, INC. AND HARRY L. CHAMBERS, *Petitioners*

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Petition for a Writ of Certiorari to the United States Court of Appeals for the 5th Circuit

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The Petitioners pray that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Fifth Circuit entered in the above case on December 12, 1972.

Opinions Below

The United States District Court, Southern District of Texas, Houston, Texas rendered no opinion. The opinion of the United States Court of Appeals, Fifth Circuit is reported at 470 F.2d 188.

Jurisdiction

The judgment of the Court of Appeals for the Fifth Circuit was made and entered on December 12, 1972, and a copy thereof is appended to this petition. The Fifth Circuit denied Petitioners' motion for rehearing on February 21, 1973, by way of a memorandum opinion and a copy is appended hereto. The jurisdiction of this Court is invoked under 28 U.S.C. 1254; because there is a conflict among the several Courts of Appeals; because the Fifth Circuit has decided an important question of federal law without discussion, which has not been, but should be settled by this Court and because the Fifth Circuit has so far departed from the accepted and usual course of judicial proceedings, as to call for an exercise of this Court's power of supervision.

Questions Presented

1. Did Congress intend to include under the protection of 10b-5 the entire sale of a business when the stock transfer was merely incidental thereto?
2. What corporate intrastate business transactions did Congress intend to cover under the provisions of 10b-5?
3. What quantum of proof is necessary to sustain the allegations of a 10b-5 proceeding?
4. Does 10b-5 preclude an officer of a merging corporation from contracting for a personal services contract with the purchasing corporation?
5. Is it necessary to instruct the jury on the measure of damages in a 10b-5 trial?

6. Should insider stockholders who do not meet the reasonable investor tests as a matter of law be allowed to recover damages in a 10b-5 proceeding?

Statutes, Federal Rules and Regulations Involved

The pertinent portions of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. sec. 78j), Rule 10b-5 (17 C.F.R. sec. 240,10b-5) prescribed by the Securities and Exchange Commission and rule 51 of the Federal rules of Civil Procedure. All of the above are attached hereto in an Appendix at pp. 30 to 31.

Statement

The United States District Court, Southern District of Texas, Houston, Texas, assumed jurisdiction pursuant to the provisions of Title 15, United States Code, Section 78aa.

Relevant Facts

Corporate Formation and Stock Ownership

FAST FOODS, INCORPORATED, a Texas Corporation was formed originally by Plaintiff, McGREGOR, and Defendant, ROOKS, in March, 1967. One Thousand shares with a par value of One Dollar each were issued by the Company, FAST FOODS INCORPORATED. Five Hundred shares were issued to Defendant, ROOKS, and Five Hundred shares were issued to Plaintiff, McGREGOR. These are the only shares ever issued and are the subject matter of this lawsuit. An additional investor, Plaintiff JACOB, was brought in during the summer of 1967, and was sold Three Hundred shares of stock. He was sold One Hundred shares by Defendant

ROOKS and two Hundred shares by Plaintiff McGREGOR. He paid One Dollar per share for his stock.

In January of 1969, ROOKS persuaded McGREGOR and JACOB to sell him a portion of their stock so that he would have a Fifty-Two percent interest and they would each have Twenty-Four percent interest in the corporation. This was accomplished by McGREGOR and JACOB selling sixty shares apiece at One Dollar per share to ROOKS. ROOKS had Five Hundred and Twenty shares and McGREGOR and JACOB each had Two Hundred and Forty shares of stock on March 20, 1969 and this was their interest in FAST FOODS, INCORPORATED at the time it was sold to H. L. H. ENTERPRISES, INC., on March 22, 1969. The stock was never traded with anyone else and was sold by the three investors as an entire unit of one thousand shares for a cash consideration of thirty dollars per share. This transaction transferred all of the outstanding stock of the corporation to H. L. H. ENTERPRISES, INC., which became the sole owner of the stock, which was collaterally pledged back to the three sellers to secure the payment of the outstanding indebtedness of FAST FOODS, INCORPORATED, which was being assumed and paid by the successor stockholder, H. L. H. ENTERPRISES, INC., and its principals. There is no history in the record of any other sales or transfers of the stock made the subject matter of this lawsuit. All sales and transfers of stock were made in Texas.

Relevant Facts

Corporate Management and Financial History

ROOKS and McGREGOR were original directors at the time FAST FOODS INCORPORATED was formed

and JACOB became a director at the time that he was brought into the corporation. All three remained on the board of directors until the corporation was sold to H. L. H. ENTERPRISES, INC. The board of directors hired Defendant ROOKS to manage the business at a salary of Fifteen Hundred Dollars per month. The record shows that ROOKS was an expert in spotting and developing prime locations and managing fast food type restaurants. Plaintiff McGREGOR was a Baptist minister who had business experience but no intimate knowledge of the fast food business. Plaintiff JACOB was in the wholesale egg business in the Houston area and was in a business allied to the restaurant business but he, too, had no expertise in the fast food business. Neither Plaintiff took an active part in the management of the day to day business affairs of the corporation.

The first restaurant was opened in October, 1967 and by January, 1969, seven units were in operation. The capital of the corporation remained the original paid in capital of One Thousand Dollars. All of the additional money used by the corporation was obtained by borrowing from banks and utilizing the cash flow of the food business of approximately One Thousand Dollars per day. An original loan of Ten Thousand Dollars was obtained for the Corporation by Plaintiff McGREGOR from his bank by pledging personal collateral. Additional loans were negotiated for the equipment and the leases were secured by the first and last months payment and the personal guarantee of McGREGOR and ROOKS. When Plaintiff JACOB became a shareholder, he arranged to allow the corporation to borrow an additional Ten Thousand Dollars by pledging personal collateral and more money was

provided by the banks for the financing of additional equipment. At one time, the total indebtedness approached Two Hundred Thousand Dollars. On January 23, 1969, the second annual stockholders meeting was held and the corporation's financial statement as of October 21, 1968, was furnished to both plaintiffs. The financial statement showed a deficit of Twenty-Six Thousand Dollars and a book value of approximately minus Twenty-Six Dollars per share. Current liabilities were Sixty Thousand Dollars and current assets were about Sixteen Thousand Dollars. The statement indicated that the cash flow from the sale of food was approximately One Thousand Dollars per day.

The statement further indicated that cash on hand and in the bank totalled Three Hundred Twenty Dollars. (D's Ex. 6) The stockholders letter from the president, Defendant ROOKS, stated that the opening of seven units had kept the profit picture from being in the black. This letter was also furnished to the stockholders at the second annual meeting. (P's Ex. 1)

Jacob's Position

Plaintiff JACOB testified that he was in the wholesale egg business doing business as JACOB'S EGG COMPANY. (T.P. P. 134, L. 15-18) That he saw the FAST FOODS financial statement for the year ending October 31, 1968 at the stockholders meeting on January 23, 1969. (T.P. P. 151, L. 18-25) (T.P. P 152, L. 1) That he had studied the statement and realized that the company had lost Twenty Five Thousand Seven Hundred Four and 26/100 Dollars in addition to the One Thousand Dollars capital put in by the shareholders. (T.P. P. 153,

L. 6-24) The president's letter to the stockholders also stated that they were operating in the red (T.P. P. 156, L. 17-22). That he trusted ROOKS and had no reason not to believe him and didn't check any of the company records himself. (T.P. P. 142, L. 5-11) (T.P. P. 146, L. 15-22) (T.P. P. 167, L. 1-25) (T.P. P. 168, L. 1-13) (T.P. P. 176, L. 2-21) That his reason for selling was ROOKS statement that approximately Twenty Five Thousand Dollars worth of checks had been written and would be hitting the bank Monday morning for collection, which funds were not there. And the feeling that Mr. ROOKS felt he did not care to continue as president or operational manager and McGREGOR and I both felt without the services of an operational manager, that we had no choice but to sell the company. (T.P. P. 145, L. 20-25) (T.P. P. 146, L. 1-11) That ROOKS said that he would be employed as a consultant by HARRY CHAMBERS, on a consultant basis for two years at the same rate of pay as he was receiving from FAST FOODS at Fifteen Hundred Dollars per month and that JACOB and McGREGOR concurred. (T.P. P. 147, L. 1-13) He stated that he would not have sold his stock for the price he got if he had known ROOKS had a contract for five years at Fifteen Hundred Dollars per month totaling Ninety Thousand Dollars. (T.P. P. 149, L. 16-22)

McGregor's Position

McGREGOR stated that he was always on the board of directors and was never denied the right to see the corporate books. (T.P. P. 99, L. 1-5) He made no inquiry of the accountant or bookkeeper. (T.P. P. 119, L. 18-25) (T.P. P. 120, L. 1-12) That he had the benefit of the financial statement of October 31, 1968 (T.P. P. 103,

L. 10-24) D's Ex. 6 showed cash on hand and in bank Three Hundred Twenty Dollars and 47/100, a stockholders equity of minus Twenty-Five Thousand Seven Hundred Four and 26/100 Dollars on One Thousand shares issued and outstanding. Current assets of Sixteen Thousand Six Hundred Eighteen and 21/100 Dollars and current liabilities of Sixty Thousand Nine Hundred Seventy-Four and 50/100 Dollars.

McGREGOR also testified that he had been in business in Dallas and had several investments with his brother in farming and ranching enterprises and had been an officer and director in an industrial rubber corporation for six years and was familiar with financial statements. (T.P. P. 108, L. 14-25) (T.P. P. 109, L. 1-10) He thought BILL ROOKS was one of the most qualified men in the fast food business that he knew; (T.P. P. 118, L. 8-14) and at the time of the sale, McGREGOR was not capable of actively managing a chain of fast food shops. (T.P. P. 117, L. 3-11) That ROOKS would work for H. L. H. ENTERPRISES as a consultant for two years and that McGREGOR suggested ROOKS get a note, "To secure this agreement." (T.P. P. 89, L. 13-25) (T.P. P. 90, L. 1-2) That he would not have sold to H. L. H. on the basis he did if he had known about the Ninety Thousand Dollar obligation to pay ROOKS in addition to the purchase price of the stock. (T.P. P. 97, L. 14-19)

Meeting of March 20, 1969

The board of directors was convened for an emergency meeting on Thursday, March 20, 1969. The meeting was called by ROOKS as operating manager and president of the corporation and at the meeting he stated that the com-

pany was losing Five Thousand Dollars a month and was in the red to the extent of Twenty-Five Thousand Dollars and had lost its ability to pay its current bills. The alternative proposals were to sell or to raise additional capital. ROOKS indicated that HARRY CHAMBERS was willing to pay Twenty Dollars a share for the company and take the company out of the financial strait it was in. Plaintiffs McGREGOR and JACOB were the only other persons in attendance at the first meeting. ROOKS also revealed that approximately Twenty Thousand Dollars had been put into the operation of the units which money had been obtained from the bank to pay for equipment to open the unit on Long Point Road and the equipment bill was due and there was Twenty Thousand Dollars needed to pay it and no money was on hand or in the bank to do so. Neither Plaintiff JACOB nor Plaintiff McGREGOR made any attempt to investigate the truth or falsity of these statements and neither testified that the statements were ever questioned by them or that they later learned that they were false. The meeting lasted from nine o'clock in the morning until six or seven o'clock in the evening. On Thursday, ROOKS revealed to McGREGOR and JACOB that if the company was sold, that he could work for H. L. H. ENTERPRISES, INC., for two years on a consultant basis at Fifteen Hundred Dollars a month. McGREGOR suggested that ROOKS get the deal secured by a note. The meeting was adjourned to reconvene the following Saturday, March 22, 1969.

Meeting of March 22, 1969

ROOKS, McGREGOR and JACOB met on Saturday morning and ROOKS stated that he had written Twenty-Five Thousand Dollars in checks to pay the outstanding

bills, the checks were hot but Mr. CHAMBERS was ready to write a check for Twenty-Five Thousand Dollars to cover the checks. (T.P. P. 122, L. 13-22)

Other alternatives were discussed one of which was to provide additional capital themselves. (T.P. P. 74, L. 13) ROOKS was cool to the idea not wanting to be involved with the business any longer. (T.P. P. 74, L. 4-6)

A potential investor was brought in who agreed to pay Twenty Thousand Dollars cash and provide an additional line of credit up to Fifty Thousand Dollars over a period of Thirty days. ROOKS indicated that he did not care to have the man in as an investor and did not care to continue in the business. He recommended that they sell to H. L. H. ENTERPRISES, INC. (T.P. P. 74, L. 6-22) CHAMBERS had indicated an interest and willingness to buy the business. (T.P. P. 75, L. 3-6) CHAMBERS was called by phone to come to the meeting. (T.P. P. 75, L. 10-14) CHAMBERS discussed whether it represented real wisdom to sell the business. He simply indicated he was willing to buy the business for the Twenty Dollars a share if they wanted to sell it. (T.P. P. 75, L. 22-25) (T.P. P. 76, L. 1) After CHAMBERS left the meeting there was more discussion about the worth of the business and the directors decided to ask if CHAMBERS would pay Thirty Dollars per share. They telephoned him and he agreed to pay Thirty Dollars a share and to assume the liabilities. (T.P. P. 76, L. 3-10)

Reasons For Granting The Writ

1. Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 of the Securities Exchange Com-

mission were never intended to cover a situation as we have in this case; and even though the Courts have liberally interpreted 10b-5 cases and broadened its scope, there must exist limits of Federal coverage. This limit has been reached in this case. The most fundamental consideration is that this case involved the entire sale of a going business. The corporations bargained at arms length for the terms of the sale. The testimony of Mr. Jacobs at pages 98 and 99 of the transcript was: "Question: To purchase, actually the going business, from you?" "Answer: That's correct." "Question: Every hamburger patty, every piece of equipment, whether it be in place or rolling stock, everything that belonged to the corporation was actually what you intended to transfer to H.L.H. Enterprises after your deal was made on March the 22nd, 1969?" "Answer: That's correct, sir."

The only opinion written covering this type transaction is that one by the United States Court of Civil Appeals in the *Chiodo v. General Waterworks Corporation* case, 380 F.2d 860 (10th Cir. 1967), wherein the Court stated: "Our first difficulty with this appeal is the sufficiency of proof to make a case. At the outset, all of the facts concerning the transaction between appellants and appellee leave us with grave doubts as to the applicability of Section 10b-5. This was something more than a corporate stock transaction, it was actually the sale of a business and the method used to convey control of the business was suggested by appellants because they derived a tax advantage therefrom and a fixed future income. During the period of time the negotiations between the parties were in progress and when the alleged false representations were made, the parties were not negotiating for the

sale of corporate stock but rather for the purchase and sale of a going private business concern. We have doubt that either the Congress in enacting the Securities Exchange Act or the Securities Exchange Commission in promulgating Rule 240.10b-5 had any intention to include a business transaction such as we have here. However, we will not pursue this reasoning because there are other clear reasons why appellants cannot prevail."

2. Congress did not intend to extend Federal jurisdiction to intrastate and local business transactions. This consideration is also vital in this type of case. The Fifth Circuit has failed to state in its opinion any facts upon which it bases any portion of its opinion, and has failed to cite any authority for its holdings either among its own opinions or those of the Supreme Court or other Circuit Courts.

The Fifth Circuit fails to spell out when, by whom or what use of interstate commerce was used by the Petitioners. If the Court felt that the phone calls invoked Federal jurisdiction under 10b-5, Petitioners would show that this was the simple use of the telephone in Houston, Texas, and that the only conversations were local in nature. As stated in the case of *Burke v. Triple A Machine Shop, Inc.*, 438 F.2d 978 (9th Cir. 1971), at page 979, "It is not contended that the mails were used. There was no interstate negotiation or purchase of the Respondent's stock. We conclude that there was also no use of an 'instrumentality of interstate commerce' within the contemplation of the statute by reason of two local telephone calls to the companies' counsel who was also an assistant secretary."

If the Fifth Circuit believed that Federal jurisdiction under 10b-5 was invoked by the mailing of the executed contract on March 27, 1969, it is in conflict with the Boone and Radiation cases below; because, the terms of the contract had been agreed upon as of March 22, 1969, as seen from the conversation at the top of page 126 of the Appendix wherein Reverand McGregor answered in response to the question of whether or not there was any re-negotiation after March 22, 1969, "No. There was no re-negotiation."

Petitioners would cite to this Honorable Court the cases of *Boone v. S. R. Baugh,* 308 F.2d 711 (8th Cir. 1962) and *Radiation Dynamics, Inc. v. Goldmuntz,* 464 F.2d 876 (2nd Cir. 1972). The Eighth Circuit in the Boone case stated at page 714, "All of the representations made by defendants were face to face and oral. The concealment of the $10,000.00 payments were entirely negative in its nature and did not involve mail use or the use of any instrumentality of interstate commerce." The Court went on to state at the bottom of page 714, "The court was also fully justified in finding that the alleged fraudulent sale of securities was completed before the mail or commerce transactions disclosed by the evidence came into operation and that the use of the mails or commerce in no way contributed to the sale of the securities here involved, or the collection of the purchase price of such securities."

As set forth in Question 1, another fundamental fact in determining if 10b-5 should be utilized in our situation is that the subject matter of this law suit is not a stock transfer but is actually the sale of all of the physical assets of FAST FOODS, INC. and its value as a going concern to

H. L. H. ENTERPRISES, INC.; not the sale of stock by the Respondents. The bargaining at all times was by *all* of the *stockholders* of FAST FOOD, INC. in their capacity as *directors* as well as stockholders. They collectively bargained with the purchaser. Each stockholder received exactly the same amounts per share from the purchaser. One must consider ROOKS' dual capacity as both stockholder and employee of FAST FOOD SERVICES, INC. His rights, powers and privileges in his capacity as stockholder is the same as the Respondents. However, he has the additional and individual right to say whether he wishes to continue to work for FAST FOODS, INC. and if not, make the best deal he can for himself with his next employer. What he received for his agreement to consult, and not to compete was strictly his business for it is his skill and forbearance that were being purchased by H. L. H. ENTERPRISES, INC. All of the consideration he receives under his personal services contract with H. L. H. ENTERPRISES is because of consideration running from himself to H. L. H., not from FAST FOOD SERVICES, INC., or from the worth of Respondents' stock. No part of this contractual consideration can be established as having watered down the value of the Respondents' stock; nor can the operative facts of this personal transaction be utilized by the Respondents subjectively to say that if they had known the contract was to last for five years instead of two that they would not have sold their stock. This sale was actually effectuated between the board of directors of each corporation and the sale of stock was merely incidental. The acts of a stockholder-director of a corporation voting to sell the assets at a given price to be divided on a pro rata basis as between himself and the other stockholders should be binding if there is no evi-

dence but that a bargained for price was paid, with valuable consideration by the purchasing corporation, for the corporation. 10b-5 was never intended to cover this situation.

Had there been worthless stock issued by the purchasing corporation or a note given with worthless collateral or some other misrepresentation to disguise the true worth of the stock, the selling corporation or its stockholders by a derivative action might bring a 10b-5 proceeding. Here we have a clean sale for cash after arms length bargaining approved by Respondents as directors of the selling corporation. Respondents' Exhibit No. 3 styled purchase agreement for corporate stock and collateral pledge security agreement page 2, paragraph B and C recognizes as clearly as the parties were able to express the thought that this was a sale of the company as a going concern. "Purchaser by making said cash payment will acquire all stock, both issued and un-issued, of the vendor, all assets of whatever nature and kind, including, but not limited to the inventory, merchandise, furniture and fixtures belonging to vendor at any or all nine locations presently existing in Houston, Texas. . . . Purchaser specifically is granted the use of the FAST FOODS, INC., trade name of Pick-Wick Coffee Shops and any and all patents, copyrights, brand and/or trade names which are now in existence or which the purchaser may subsequently desire to acquire, which includes, but shall not be limited to SERVICEMARK, No. 860306 issued by the United States Patent Office on November 12, 1968."

3. & 4. The burden of proof in a 10b-5 case as in other civil cases is upon the Plaintiff. Therefore, what proof was before the Court and Jury as of the date this

transaction was consummated? There is no denying that the transaction was consummated as of March 22, 1969.

To invoke the Federal protection of 10b-5, there first must be a finding that something material was done that defrauded the Respondents. The next step is at what point in time do the events become material. The only evidence as of March 22, 1969, was that ROOKS was to have a two year consultant contract at $1,500.00 per month. March 22, 1969, was the date that the purchase and sale of FAST FOODS, INC. was agreed upon. Therefore, under the materiality test as set out in the Radiation Dynamics case, there had to be fraudulent conduct at that stage or there could be no fraudulent conduct within the contemplation of 10b-5.

The Second Circuit in the Radiation Dynamics case at page 890, set out the materiality test as follows: "Radiation Dynamics Inc. argues that there was error in Judge Pollack's instruction to the jury that the date at which materiality was to be determined was, in the judge's words: . . . 'the date when an insider has committed himself to purchase the stock.' It is not any later date, such as, for example, the formal closing date when the delivery and payment are formally completed and cleared. To determine whether fraud was perpetrated you look to the situation at the date when the parties committed themselves. There is no obligation to pull back from a commitment previously made by the buyer and accepted by the seller because of after acquired knowledge."

Therefore, Petitioners contend that after the meeting of the minds on March 22, 1969, there was no duty to

disclose that ROOKS and H. L. H. ENTERPRISES, INC., at a later date, entered into a five year, instead of two year, consultant and non-competition contract at $1,500.00 per month. They were under no duty to disclose this fact; they could not be guilty of any fraudulent action under 10b-5.

To summarize, what ROOKS did in enlarging his personal service contract after the collective sale of FAST FOOD SERVICE to H. L. H. ENTERPRISES, INC. could in no way alter the value of any share of stock of the corporation at the time of sale. What ROOKS did for five years instead of two years after the sale could not effect the investment judgment of the Respondents; they admitted they knew ROOKS had a consultation agreement for two years with H. L. H. ENTERPRISES in which they not only acquiesced but also suggested he strengthen by securing a note to secure his employment for the period of two years. They cannot logically justify the statement that they would not have sold their stock if they had known about the agreement being changed from two to five years.

ROOKS did give up personal consideration to the new employer, H. L. H. ENTERPRISES, not only for the consultation but also for his covenant not to compete, consult or work for any competitor of H. L. H. ENTERPRISES. The Texas Courts have long held that specific performance will be granted where a person, who has agreed not to, accepts employment in a competing business. Such a covenant may be enforced by injunction against its breach. *Bettinger v. North Ft. Worth Ice Co.*, (CA) 278 S.W. 466; *Byers v. Trans-Pecos Abstract Co.*, (CA) 18 S.W.2d 1096.

Likewise, where the restraint imposed is reasonable, the seller of a business may agree to refrain from starting another business in competition with the buyer or from working for a competitor, so long as the restraint is reasonable in subject matter, territorial boundaries, and length of time in so far as they are necessary to secure the good will purchased by the buyer of the business. *City Ice Delivery Co. v. Evans,* (CA) 277 S.W.2d 769; *Barret v. Curtis,* 407 S.W.2d 359, (CA) 278 S.W. 466; *Bailey v. Taylor,* (CA) 277 S.W.2d 769.

The business consideration that the owners and managers of H. L. H. ENTERPRISES, INC. faced at the time of acquisition of FAST FOOD SERVICES, INC was that Mr. ROOKS as the active manager and originator of the seven restaurants and the company organization posed a real competitive threat. If ROOKS did not work for H. L. H. ENTERPRISES, he might very easily pirate the employees and develop future potential locations for himself and carry the FAST FOOD SERVICES good will with him to his next employer. What H. L. H.'s management was willing to pay for his services and his agreement not to compete should be strictly their and ROOKS' business. ROOKS, while this law suit is pending, which is less than five years since the signing of the contract, is restricted in what he personally can and cannot do under the terms of his agreement with H. L. H ENTERPRISES, INC. McGREGOR and JACOB are not restricted in anyway and have received full consideration for what they had to sell, their proportionate share of the going business. ROOKS had something else to sell; his knowledge, ability in the fast food business, and his agreement not to compete in Texas with H. L. H. ENTERPRISES. H. L. H. ENTERPRISES wanted what

he personally had to sell and they paid fair consideration for it. Neither McGREGOR nor JACOB should have the right to share in one penny of the consideration of the Fifteen Hundred Dollars per month moving from H. L. H. ENTERPRISES to ROOKS.

5. Admittedly, Rule 10b-5 is silent as to a proper measure of damages. However, the cases which have been decided under Rule 10b-5 have not been silent as to a proper measure of damages in a 10b-5 case. The various rules and guidelines established by these cases will be discussed. It is however important to note that Petitioners have not been able to find a single case that will support the unbridled speculation of the Jury as a measure of damages in this or any other cause of action before the Courts of our Federal system. There are no punitive damages under Rule 10b-5. *Baumel v. Rosen,* 412 F.2d 571, (1969). The unbridled speculation of the Jury as to the damages incurred as a result of a violation of 10b-5 would in itself constitute punitive damages. It has long been the law of this land that damages must not be speculative or probable, and they must be proven with a reasonable degree of certainty. *Classic Bowl, Inc. v. AMF. Pinspotters, Inc.,* 403 F.2d 463, (1968).

While there are other cases which further develop theories of damages, there are no cases which either set forth a substantially different measure of damages or hold that the Jury may speculate as to damages. *Esplin v. Hirschi,* 402 F.2d 94, (1968); *Baumel v. Rosen,* 421 F.2d 571, (1969). As mentioned earlier, the Respondents seek to use the contract between J. W. ROOKS and H. L. H. ENTERPRISES, INC. dated March 25, 1969, as evidence of a fraud. The contract is, on its face, and

under the facts of this case a legitimate contract. The Respondents apparently wish to rely solely on the fact that it was executed at or about the time of the contract calling for the sale of Respondents' stock as evidence of fraud. However slim that may be, it is certainly improper to further use the total consideration moving to ROOKS under the terms of the contract as a measure of damages. The Respondents argued to the jury that this was the measure of damages and it is the only support for the jury's verdict. There is not a reported case under 10b-5 which sets out a measure of damages not related by some probative evidence to the value of the stock transferred. The Respondents failed to prove any damage and the verdict should be set aside.

Your Petitioners respectfully request that this Honorable Court, should it sustain the lower court's judgment order a remittitur and reduce the amount of damages in this case to the figure of $25,920.00 which is the only amount of actual damages that the Respondents could be entitled to under any theory of damages related to ROOKS' personal service contract. This amount is arrived at as follows: at the top of page 108 of the Appendix is found the testimony of REVERAND McGREGOR; he stated that he knew as of March 22, 1969, that BILL ROOKS was to receive $1,500.00 per month for two years (for a total of $36,000.00), and that it was all right for ROOKS to receive said amount. On March 22, 1969, ROOKS owned 52% of FAST FOODS, INC., stock and McGREGOR and JACOB together owned 48% of the stock. Since McGREGOR and JACOB agreed to the two year contract, they may only complain of the additional three (3) years at $1,500.00 per month which

amounts to $54,000.00. A 10b-5 recovery must be based upon the stock price itself or the pro rata added value of the stock by a side payment. To prevent exemplary damages, the Respondents must be limited to 48% of $54,000.00 as ROOKS by his stock ownership would be entitled to 52% of this amount. The Respondents are not entitled to claim all of the $54,000.00 when they owned only 48% of the stock. They must be limited to 48% of the actual difference in value or $25,920.00 and your Petitioners respectfully request that this Honorable Court re-compute the amount of damages that they could be entitled to under a 10b-5 type of action; since they are not entitled to exemplary damages or to attorney's fees directly or indirectly. *Classic Bowl, Inc. v. A.M.F. Pinspotters, Inc.*, 403 F.2d 463 (7th Cir. 1968), *Baumel v. Rosen*, 412 F.2d 571 (4th Cir. 1969).

6. The fact that the Plaintiff-investor did in fact rely upon a misrepresentation or nondisclosure is immaterial if Plaintiff fails to meet the reasonable investors test. *City National Bank of Fort Smith, Ark. v. Vanderboom*, (422 F.2d 221 (1970) 8th Cir.) sets out this standard or test as follows, "We think this two-step test breaks down as follows: (1) With regard to misrepresentations, the question is whether a reasonable investor, in light of the facts existing at the time of the misrepresentation and in the exercise of due care, would have been entitled to rely upon the misrepresentation. With regard to nondisclosures, the issue becomes whether a reasonable investor, in light of the facts existing at the time of the nondisclosure and in the exercise of due care, would have been entitled to receive full disclosure from the party charged and would have acted differently had the alleged nondisclosure not occurred. (2) If the Plaintiff satisfies this "in

connection with" step, it then becomes necessary to determine whether the Defendant's misrepresentation or nondisclosure was made with scienter or from a lack of due diligence. See *Texas Gulf Sulphur Co.*, 401 F.2d at 863.

It should be noted from the outset that this "reasonable investor" test is an objective standard. Whether an investor did in fact rely upon a misrepresentation is immaterial for the purpose of determining statutory coverage, though reliance is a predicate for recovery once coverage is established. In applying this test to the instant case, we find a reasonable investor would not have relied upon any representations made by ROOKS and that HARRY CHAMBERS did not owe a duty of full disclosure to the investors, McGREGOR and JACOB, of any change in the consultation contract with ROOKS. The investors had access to all the books and records of FAST FOODS, INC. in their capacity as directors during the negotiation period. They have never seen the company books. CHAMBERS was personally present at the March 22, 1969 meeting and could have been questioned by the Plaintiffs as to the future of ROOKS with H.L.H. ENTERPRISES, INC. The truth is that their investment judgment of whether to sell or continue the business was not affected by ROOKS personal employment. As stated in *Myzel v. Fields*, 386 F.2d at 736: "(T)here is no duty to disclose information to one who reasonably should already be aware of it. Nor is there the necessity for one insider to 'search out details' for another insider, in the same sense that such a duty might exist towards others less informed."

Further support for our conclusion is found in *Kohler v. Kohler Co.*, 319 F.2d 634 (7th Cir. 1963), 7 A.L.R. 3d 486, where the Seventh Circuit held that the failure

of a director of the corporation to disclose material facts to the plaintiff will not lead to liability under 10b-5 where the plaintiff himself has the ability and the opportunity to discover those facts easily. The Supreme Court has also had occasion to state this general principal:

> "When the means of knowledge are open and at hand or furnished to the purchaser or his agent and no effort is made to prevent the party from using them, * * * he will not be heard to say that he has been deceived to his injury by the misrepresentations of the vendor." *Shappirio v. Goldberg*, 192 U.S. 232, 241-242, 24 S.Ct. 259, 48 L.Ed. 419 (1904).

> "Since the investors in the case at bar had ready access to the information involved, it is reasonable to expect them to exercise a higher degree of care than third parties who were not sellers and did not profit from the sale but who might have had some peripheral or general knowledge about the financial condition of AHB."

7. The trial court's action in dismissing H. L. H. ENTERPRISES, INC. was not unexplained in the briefs filed with the Court. The Court of Civil Appeals assumes and states as a fact that the jury returned a verdict against ROOKS, CHAMBERS and H. L. H. ENTERPRISES, INC. This is factually incorrect in that as noted at page 38 of Cross Appellant's Brief, paragraph one, "The trial court, however did not submit to the jury a special interrogatory regarding H. L. H. ENTERPRISES, INC." The Plaintiff had the burden of proof in objecting to the charge as is required by Rule 51 of the Federal Rules of Civil Procedure, and by not objecting, the failure to submit a special interrogatory inquiring about H. L. H. EN-

TERPRISES, INC. participation in a "deceptive device" took Defendant H. L. H. ENTERPRISES, INC. out of the case.

The law applicable in this case was stated in *National Sur. Corp. v. City of Excelsior Springs, Mo.* (CCA 8th, 1941) 123 F.2d 573 when the Court said, "Instructions not objected to are the law of the case on appeal, and the sufficiency of the evidence to sustain the verdict is tested by the law announced in such instruction." The appellants would further cite to this Honorable Court the cases of *Bernstein v. Olian* (S.D. N.Y., 1948) 77 F.Supp. 672: "A verdict may not be set aside for inconsistency where the inconsistency was permitted by instructions to which no objection was made," and *Federated Mut. Implement & Hardware Ins. Co. v. Fairfax Equip. Co.* (CA 10th, 1958) 261 F.2d 207: "Without 'seasonal objection,' the court will not review on appeal the giving or failure to give certain instructions." The same result obtains when there is a failure to object to a refusal to give requested instructions; review on appeal is precluded. *Ziegler v. Akin* (CA 10th, 1958) 251 F.2d 88; *Filipek v. Moore-McCormack Lines* (CA 2d, 1958) 258 F.2d 734, cert. denied (1959) 359 U.S. 927, 79 S.Ct. 605, 2 L.Ed.2d 629. Also see *Chiodo v. General Waterworks Corp.*, 380 F.2d 860, 1967 at page 864, "The first of these points, in effect, urge error by the trial judge in his instructions to the jury. These points can be cognizable here only if appellants, at the trial, complied with the clear mandate of Rule 51, Federal Rules of Civil Procedure. This court has written many times concerning its interpretation of this rule. The cases hold, in substance, that any objections to instructions must be made of record after the court has

given his instructions to the jury and before the jury retires to deliberate upon the case; and that, in making such objections, the party objecting must state 'distinctly the matter to which he objects and the grounds of his objection'."

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIX A

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 72-1245

A. W. McGREGOR and KERVIN E. JACOB,
Plaintiffs-Appellees-Appellants,

versus

H. L. H. ENTERPRISES, INC.,
Defendant-Appellee,

J. W. ROOKS and HARRY L. CHAMBERS,
Defendants-Appellants.

Appeals from the United States District Court for the Southern District of Texas

(December 12, 1972)

Before TUTTLE, WISDOM and SIMPSON,
Circuit Judges.

PER CURIAM: This is an appeal from a judgment, following a jury verdict in favor of the appellees, McGregor and Jacob, resulting from a suit filed by them under Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.A. Sec. 78j.[1]

1. §78j. Manipulative and deceptive devices.
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce

We conclude that there is no merit in either the contention of appellants (1) that an instrumentality of interstate commerce was not utilized either "directly or indirectly"; (2) that there was insufficient evidence to submit to the jury the question whether the sale of McGregor's and Jacob's stock was attributable to the use of a "deceptive device"; or (3) that the court erroneously charged the jury as to the measure of damages. We conclude, therefore, on the appeal by the defendants below that the judgment must be AFFIRMED.

McGregor and Jacob appeal from the unexplained act of the trial court in dismissing H.L.H. Enterprises, Inc. from the case, after the jury had returned a verdict against Rooks, Chambers (President of H.L.H. Enterprises, Inc.) *and* H.L.H. Enterprises, Inc., the purchaser of the stock. H.L.H. filed no brief in this court undertaking to support this unexplained action by the trial court. We conclude that the jury's verdict against the corporation was fully supported, and, therefore, that the trial court erred in failing to enter a judgment against the corporation.

The case is, therefore, REMANDED to the trial court with directions to reinstate H.L.H. Enterprises, Inc. as a defendant, and to include this defendant in the judgment in favor of McGregor and Jacob.

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or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. 15 U.S.C.A. §78j.

APPENDIX B

IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

No. 72-1245

A. W. McGREGOR and KERVIN E. JACOB,
Plaintiffs-Appellees-Appellants,

versus

H. L. H. ENTERPRISES, INC.,
Defendant-Appellee,

J. W. ROOKS and HARRY L. CHAMBERS,
Defendants-Appellants.

Appeals from the United States District Court for the Southern District of Texas

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(February 21, 1973)

ON PETITION FOR REHEARING

Before TUTTLE, WISDOM and SIMPSON,
Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing on behalf of Harry L. Chambers and H.L.H. Enterprises, Inc. filed in the above entitled and numbered cause be and the same is hereby DENIED.

APPENDIX C

15 U.S.C. 78j, Sec. 10 (b), "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * * * * * * * * * * *

"(b) To use or employ, in connection with the purchase or sale of any securities registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. June 6, 1934, c. 404, 10, 48 Stat. 891."

Rule 10b-5, 17 C.F.R. 240.10b-5, "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

28 U.S.C. Sec. 1254, "Cases in the courts of appeals may be reviewed by the Supreme Court by the Following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree;

Rule 51, Federal Rules of Civil Procedure, "At the close of the evidence or at such earlier time during the trial as the court reasonably directs, any party may file written requests that the court instruct the jury on the law as set forth in the requests. The court shall inform counsel of its proposed action upon the requests prior to their arguments to the jury, but the court shall instruct the jury after the arguments are completed. No party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. Opportunity shall be given to make the objection out of the hearing of the jury."